

**EXHIBIT B**

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1 UNITED STATES DISTRICT COURT  
1 SOUTHERN DISTRICT OF NEW YORK

2 -----x

3 In Re CALPINE CORPORATION, et al.

4 -----x

5 SOUTHERN CALIFORNIA EDISON  
5 COMPANY, et al.,

6 v.

05 Civ. 10842 (RCC)

7 CALPINE CORPORATION, et al.,

Argument on Motion

8 Defendants.

9 -----x

New York, N.Y.  
January 4, 2006  
3:30 p.m.

11 Before:

12 HON. RICHARD CONWAY CASEY

District Judge

14 APPEARANCES

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1 (Case called)  
2 THE CLERK: Counsel, please identify yourselves for  
3 the record.  
4 MR. SHINDERMAN: Your Honor, Mark Shinderman, Munger,  
5 Tolles & Olson, on behalf of Southern California Edison  
6 Company, plaintiff and movant.  
7 THE COURT: Good afternoon, Mr. Shinderman.  
8 MR. RASKIN: Your Honor, David Raskin, Steptoe &  
9 Johnson, for plaintiff-movant Southern California Edison  
10 Company.  
11 THE COURT: Mr. Raskin, good afternoon.  
12 MR. POSNER: Good afternoon, your Honor. David  
13 Posner, Hogan & Hartson, for Southern California Edison  
14 Company.  
15 THE COURT: Mr. Posner, good afternoon.  
16 MR. CUNNINGHAM: Good afternoon, your Honor. Keith  
17 Cunningham from Pierce Atwood, for the Southern California

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18 Department of Water Resources and California Electricity  
19 Oversight Board.  
20 MR. LUSKIN: Your Honor, Michael Luskin, Luskin, Stern  
21 & Eisler, for the California parties, that is, the California  
22 Department of Water Resources, the California Electricity  
23 Oversight Board, and the Attorney General of the State of  
24 California.  
25 THE COURT: Good afternoon, sir.  
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1 MS. COFFINO: Good afternoon, your Honor. Diane  
2 Coffino from Dewey Ballantine LLP on behalf of Pacific Gas &  
3 Electric company.  
4 THE COURT: Good afternoon.  
5 MR. HAYDEN: Good afternoon, your Honor. Patrick  
6 Hayden of McGuireWoods representing Strategic Energy LLC and  
7 Northern California Power Agency. We have filed a joinder in  
8 the motions of the other parties here.  
9 THE COURT: Good afternoon.  
10 MR. CANTOR: Good afternoon, your Honor. Matthew  
11 Cantor, Kirkland & Ellis, on behalf of Calpine Corporation. I  
12 would like to introduce my partner, Jeffrey Powell, also of  
13 Kirkland & Ellis. I would also like to move his admission pro  
14 hac vice. He is a member in good standing of the bars of  
15 Illinois and the District of Columbia. I have his pro hac  
16 motion prepared with a certificate of good standing that we are  
17 ready to file.  
18 MR. POWELL: Good afternoon, your Honor.  
19 THE COURT: Your application is granted. Go ahead and  
20 file the papers to complete it. Thank you.  
21 MR. POWELL: Thank you, your Honor.  
22 MR. LUSKIN: Your Honor, may I be heard on a pro hac  
23 motion as well? Michael Luskin. I would like to move the pro  
24 hac motions of Keith Cunningham, who introduced himself, and  
25 his partner Jared des Rosiers, who is here in this courtroom.  
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1 They are here from the Pierce Atwood firm in Portland, Maine.  
2 They are in good standing and are in the process of filing the  
3 necessary fee. Also, on the phone are Martin Goyette, who is  
4 the supervising deputy attorney general of the State of  
5 California, and Irene Tamura, a deputy attorney general. Both  
6 attorneys are in good standing in the State of California. I  
7 move their admission. Their papers are also in the works and  
8 payment of their fees is being made.  
9 THE COURT: Your applications are granted.  
10 MR. LUSKIN: Thank you, your Honor.  
11 THE COURT: Is there anyone else?  
12 MR. POSNER: Your Honor, David Posner again, from  
13 Hogan & Hartson, for Southern California Edison Company. Mr.  
14 Shinderman and Mr. Raskin have already introduced themselves on  
15 behalf of Southern California Edison Company. Mr. Shinderman  
16 is a member of the bar of California in good standing, and Mr.  
17 Raskin is a member of the bar of the District of Columbia in  
18 good standing. We will be filing the appropriate papers and  
19 filing the necessary fees. I would move their admission pro  
20 hac as well, your Honor.  
21 THE COURT: Your application is granted. If it gets  
22 any larger, we are going to have to make up programs, I think.

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23 Everybody is on the record now? All right.  
24 Before we get started, who will be arguing for the  
25 movants and how much time? I wasn't informed that anybody  
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1 called in with any desired time for their argument.  
2 MR. SHINDERMAN: Your Honor, Mark Shinderman of  
3 Munger, Tolles & Olson. On behalf of the plaintiff movants, I  
4 will start. I require approximately 10 to 15 minutes, probably  
5 10 minutes.  
6 THE COURT: That shows good judgment. If that doesn't  
7 send a little hint to the rest, then they shouldn't be here.  
8 MR. SHINDERMAN: Seven minutes, your Honor.  
9 THE COURT: You are getting dearer to my heart every  
10 minute.  
11 MR. SHINDERMAN: Following me, your Honor, California  
12 would like to be heard as well as PG&E. I will let Mr.  
13 Cunningham and Ms. Coffino indicate how long they anticipate.  
14 MR. CUNNINGHAM: Keith Cunningham for Department of  
15 Water Resources and Electricity Oversight Board. I would  
16 expect that we would take up no more than five minutes, and I  
17 will certainly try and move that closer to one or two or three  
18 minutes as we go along.  
19 THE COURT: Duplication doesn't score anything with  
20 me, so hit the points you want to make. Go ahead. That will  
21 be fine. It will be just the two of you then?  
22 MS. COFFINO: Diane Coffino from Dewey Ballantine on  
23 behalf of Pacific Gas & Electric Company. We will be arguing  
24 as well, but we will try to keep it to under five minutes,  
25 maybe three if possible, to move things along.  
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1 THE COURT: It is wonderful as to how it spreads.  
2 Now I have to hear from Kirkland & Ellis?  
3 MR. SHINDERMAN: Yes, sir. Jeff Powell on behalf of  
4 the debtors, your Honor, and I have just dramatically lowered  
5 the time estimate.  
6 THE COURT: Oh, you're quick. They always said that  
7 about you.  
8 MR. POWELL: I am editing as I speak. I think ten  
9 minutes will be fine.  
10 THE COURT: Fine. Good people, who will lead off?  
11 MR. SHINDERMAN: Your Honor, again, Mark Shinderman,  
12 Munger, Tolles & Olson, Southern California Edison Company.  
13 THE COURT: It is in your court.  
14 MR. SHINDERMAN: Your Honor, thank you for considering  
15 the motion to withdraw on short notice. As you know, the  
16 debtor, Calpine, filed a motion to reject certain contracts  
17 that provide purchase of electricity generated from the  
18 debtors. These contracts constitute rates filed with and  
19 subject to the jurisdiction of the Federal Energy Regulatory  
20 Commission.  
21 Resolution of the rejection motion requires, as a  
22 predicate, a court to create two related questions. First, in  
23 what form should the motion be resolved? Second, and depending  
24 on the answer to the first, what standards should be applied?  
25 To answer these two questions, the Court must  
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1 necessarily consider both the Federal Power Act and the  
 2 bankruptcy code. As such, under 28 U.S.C. Section 157,  
 3 withdrawal of the reference is mandatory.

4 If it is OK with you, your Honor, I wish to provide a  
 5 brief factual background and then a legal analysis to help  
 6 frame our discussion.

7 The facts are simple and are not in dispute. Just  
 8 prior to Calpine's filing bankruptcy on December 19, 2005, the  
 9 California Department of Water Resources, which I will refer to  
 10 as "the state," filed an application before the commission  
 11 seeking an order directing Calpine to continue to supply power  
 12 under California's contract with Calpine.

13 On December 20th, Calpine Corporation and its  
 14 affiliated debtors commenced their bankruptcy cases by filing  
 15 bankruptcy petitions. Immediately thereafter, on December  
 16 21st, the next day, Calpine, the debtors, filed motions to  
 17 reject eight power purchase contracts. That motion is  
 18 scheduled for hearing before the bankruptcy court tomorrow  
 19 pending resolution of the issue before you today.

20 In the rejection motion, Calpine indicates that it  
 21 would like to reject the power purchase contracts so it may  
 22 sell the energy otherwise committed to the eight parties,  
 23 counterparties to the contracts, for a higher rate. In  
 24 Calpine's own words, they remain willing and able to commit to  
 25 sell that power to either the same parties or new parties at a

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1 higher price. In fact, in their moving papers, Calpine  
 2 indicates that there will not be a disruption in the  
 3 electricity supply because the energy will remain available.  
 4 Seen in this light, this case is about attracting a higher  
 5 rate.

6 Yesterday, the Federal Energy Regulatory Commission  
 7 issued an order, which they designated an order providing  
 8 interim guidance, in which the commission indicated that --

9 THE COURT: Does that have any legal significance?  
 10 What does that mean?

11 MR. SHINDERMAN: Your Honor, we asked that very  
 12 question amongst ourselves earlier, and the answer is there is  
 13 none. There was no proper proceeding, there was no evidentiary  
 14 hearing, and there was no opportunity to be heard.

15 THE COURT: Was there an application made by you on  
 16 the 19th of December or one of your number?

17 MR. SHINDERMAN: Yes, your Honor. An application was  
 18 made by the State of California, the California Department of  
 19 Water Resources, on the 19th. On the 20th, when the bankruptcy  
 20 case was commenced --

21 THE COURT: Nothing happened at FERC as a result of  
 22 that application, is that correct?

23 MR. SHINDERMAN: That's correct.

24 THE COURT: The next day they filed the bankruptcy?

25 MR. SHINDERMAN: That's correct.

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1 THE COURT: And the following day they applied for the  
 2 TRO?

3 MR. SHINDERMAN: That's correct, your Honor.

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4 THE COURT: Let me ask you a question. I don't mean  
5 to knock you off stride. Do you believe this Court has the  
6 power to strike down the TRO that the bankruptcy court has  
7 issued?  
8 MR. SHINDERMAN: Your Honor, I believe this Court has  
9 the power to withdraw the reference to both this pending  
10 motion --  
11 THE COURT: Withdraw the reference, that is a separate  
12 question. Short of withdrawing the reference, does this Court  
13 have the power?  
14 MR. SHINDERMAN: I have not briefed the issue, your  
15 Honor, but I do not believe that the Court, sitting in its  
16 appellate capacity, which that would be, has the power to  
17 reverse a TRO. A preliminary injunction --  
18 THE COURT: If we were to suspend the reference, then  
19 of course we could deal with it, is that correct?  
20 MR. SHINDERMAN: That is correct, your Honor.  
21 THE COURT: Would it be your intention to go back to  
22 the FERC if the reference was suspended?  
23 MR. SHINDERMAN: Absolutely, your Honor. In fact, one  
24 of the issues we have is that most of the parties that are  
25 appearing before you today as movants never had an opportunity  
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1 to make any submission to the commission precisely because the  
2 automatic stay precluded them from doing so, and then the TRO  
3 prevented them from proceeding any further. That is precisely  
4 one of the implications of the motion to withdraw the  
5 reference. That is how we propose to proceed, in part.  
6 THE COURT: Have any of you ever seen such a letter as  
7 the FERC issued yesterday?  
8 MR. SHINDERMAN: Your Honor, just by an informal poll  
9 of counsel in the last two hours, since we got together, we  
10 have not. This is an order providing guidance. We have seen  
11 decisions of FERC, we have seen rulings from FERC, but we have  
12 not seen an order providing guidance.  
13 THE COURT: It was kind of interesting that they  
14 thought that they could tell the district court what their  
15 jurisdiction was. That kind of interested me. Nonetheless, go  
16 on.  
17 MR. SHINDERMAN: Your Honor, we thought it was  
18 interesting for other reasons as well. In that order providing  
19 interim guidance, the commission stated three things:  
20 (1) that the bankruptcy court here should consider the  
21 public interest in deciding whether Calpine may reject these  
22 eight power purchase contracts;  
23 (2) that the commission should be given an opportunity  
24 to solicit comments about that public interest; and  
25 (3) that the commission should be given an opportunity  
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1 to present its conclusions about the public interest to the  
2 bankruptcy court.  
3 Far from clarifying the issues in the underlying  
4 matter before you today, the FERC's guidance underscores why  
5 withdrawal of the reference is mandatory.  
6 To address the two questions that I posed at the  
7 outset, what forum should ultimately decide the rejection  
8 motion and what standard should be applied, a court must



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9 necessarily consider two competing statutory frameworks, the  
 10 bankruptcy code and the federal Power Act.  
 11 Bankruptcy Code Section 365 provides that a debtor may  
 12 reject an executory contract. According to the debtor,  
 13 Calpine, in their briefs before the bankruptcy court, the  
 14 standard to be applied in their rejection decision is the  
 15 business judgment of the debtor. Public interest need not be  
 16 considered, external factors need not be considered, the input  
 17 of the commission need not be considered. The only thing that  
 18 is relevant, according to the debtors, in reliance on Orion  
 19 Pictures and other cases, is that the business judgment of the  
 20 debtor had been properly exercised.  
 21 The Federal Power Act, however, has a different scheme  
 22 for resolving disputes such as this. Calpine entered in the  
 23 contracts at issue, the eight purchases power contracts,  
 24 pursuant to its market-based tariffs it filed with the  
 25 commission. As such, the contracts, together with Calpine's  
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1 market-based rate authorization, constitute filed rates.  
 2 Under the Federal Power Act Sections 201, 205, and  
 3 206, filed rates are the subject of the commission's plenary  
 4 and exclusive jurisdiction. Under Section 205 the commission  
 5 alone has the power to prescribe rules and regulations under  
 6 which rates may be administered and modified. Likewise, under  
 7 the filed rate doctrine announced by the Supreme Court,  
 8 wholesale power sales agreements under the commission's  
 9 jurisdiction are not mere contract; they can be changed only by  
 10 the commission, in accordance with Sections 205 and 206 of the  
 11 Federal Power Act. Likewise, an agreement subject to the  
 12 commission's jurisdiction must be respected by the courts. A  
 13 collateral attack on such agreement is prohibited. The  
 14 decision of the commission may only be reviewed by the circuit  
 15 court.  
 16 This is an important statutory scheme. Section 1 of  
 17 the Federal Power Act says the commission's jurisdiction exists  
 18 to protect consumers, who are typically not the parties, the  
 19 counterparties, to such agreements. That stands in marked  
 20 contrast to the bankruptcy code, where the debtor, in an  
 21 attempt to maximize its estate, looks to its business judgment,  
 22 what benefits the estate only, not the public interest.  
 23 Your Honor, the decision of FERC, the guidance  
 24 provided, is troubling for a number of reasons. It starts with  
 25 the assumption that the Mirant case under the Fifth Circuit is  
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1 binding on it. It is not. As the debtor in its opposition  
 2 papers points out, Mirant not is the law of this circuit.  
 3 According to the debtor, the only standard that is relevant is  
 4 the debtor's business judgment.  
 5 In FERC's guidance, FERC says the public interest must  
 6 be considered and that the commission must be afforded an  
 7 opportunity to both consider that public interest and present  
 8 it to the bankruptcy court. Again, the debtor here says under  
 9 the bankruptcy code that that, too, is irrelevant.  
 10 The other interesting issue here is the factual  
 11 position in which we find ourselves. In the Fifth Circuit the  
 12 Mirant court said, and the debtor Mirant conceded, that if the  
 13 action to reject the contract was solely about changing the



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14 filed rights, then indeed the commission would have exclusive  
15 jurisdiction.

16 Here, the commission did not have any factual record.  
17 The factual record adduced by the affidavit of Mr. Pizzoli was  
18 appended to the debtor's motion to reject the contract. In  
19 other words, the only facts in this case of what the debtor's  
20 inventions are were first presented to the bankruptcy court and  
21 have never been before the commission.

22 But in his affidavit Mr. Pizzoli indicates, as I  
23 mentioned at the outset, that Calpine remains ready, willing,  
24 and able to sell power, just at a higher price. In Mirant, in  
25 contrast, the debtor had committed to purchase energy from

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1 other parties and then overcommitted. It didn't need all the  
2 energy it was under contract to purchase. It wasn't about  
3 renegotiating a filed rate. It was about freeing itself from a  
4 contract that was no longer necessary. Here, in contrast,  
5 Calpine says it remains ready, willing, and able to sell the  
6 power into the marketplace.

7 Your Honor, also of interest, in the Mirant case the  
8 district court did withdraw a motion of the reference to the  
9 bankruptcy court, both the motion to reject the contract and a  
10 related adversary action. Although the Fifth Circuit reversed  
11 the district court's ruling on certain points, the Fifth  
12 Circuit did not rule that withdrawal of the reference was  
13 inappropriate.

14 Finally, your Honor, this Court, in its NRG decision,  
15 found that indeed the commission, the Federal Energy Regulatory  
16 Commission, has exclusive jurisdiction over attempts to change,  
17 modify, or alter rates that are on file and subject to the  
18 commission's jurisdiction.

19 Where that leaves us, your Honor -- consistent with my  
20 promise to keep this to seven minutes -- we have two issues  
21 that a court needs to decide: What forum must make the  
22 decision on the rejection motion, and what standard: Public  
23 interest, business judgment, how do we administer the public  
24 interest, how does it get heard? Those two issues must be  
25 resolved.

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1 To resolve those two issues, a court must necessarily  
2 consider both the Federal Power Act and the bankruptcy code,  
3 because the presence and interplay of those two statutes, the  
4 bankruptcy code and nonbankruptcy federal law 28 U. S.C.  
5 Section 157(d), mandates withdrawal of the reference.

6 Finally, your Honor, I would note that in the  
7 alternative, and as noted in the papers, permissive withdrawal  
8 of the reference would also be appropriate to the extent that  
9 the parties need guidance on what the applicable standard is.  
10 The bankruptcy court, according to the debtor's papers, should  
11 only apply the business judgment. FERC's guidance, rulings  
12 from other jurisdictions, rulings from this court, suggest that  
13 FERC has a role, if not an exclusive role. So fashioning a  
14 standard at the very least is required.

15 For those reasons, your Honor, Southern California  
16 Edison respectfully requests that the Court withdraw reference  
17 of the motion.

18 THE COURT: I take it, bottom line, that what you are  
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19 suggesting is the actions of your opponents are an attempt to  
20 pull an end run.  
21 MR. SHINDERMAN: Your Honor, without casting  
22 aspersions, I would suggest that the filing --  
23 THE COURT: We use such fundamental language here in  
24 New York. We are getting ready for a playoff game. We have to  
25 get down and dirty here. I think you folks from Washington  
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1 have some sort of a contest in the South someplace. "The game"  
2 is here. With that said, I believe you in kinder words are  
3 suggesting that is the course here.  
4 MR. SHINDERMAN: Your Honor, we believe that the  
5 timing of the bankruptcy petition was influenced in part by the  
6 submission of the state to the commission trying to seek, in  
7 effect, a ruling that no matter what happens in the future, the  
8 debtor must continue to supply power to the state of  
9 California.  
10 THE COURT: Certainly the time line is interesting.  
11 OK. I will try and help everybody stick to their schedules.  
12 Who is next?  
13 MR. CUNNINGHAM: Judge, this Keith Cunningham for the  
14 Department of Water Resources --  
15 THE COURT: Yes, sir.  
16 MR. CUNNINGHAM: -- and California Electricity  
17 Oversight Board. I will try to keep my remarks brief and focus  
18 on the second issue that we believe requires consideration of  
19 nonbankruptcy federal law, that being the standard of review if  
20 the jurisdiction question comes out that the bankruptcy court  
21 has some role to play in rejection of a FERC jurisdictional  
22 power contract.  
23 To do that, if the Court would like, I would like to  
24 spend a few moments briefly outlining the history of the energy  
25 crisis and how the Department of Water Resources contract came  
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1 to be and the important provisions that were included within  
2 that contract to address issues that arose during the energy  
3 crisis.  
4 THE COURT: It is still included in your time limit,  
5 to give you a slight history of this.  
6 MR. CUNNINGHAM: As I said, I will keep it brief with  
7 that in mind.  
8 The California energy crisis was precipitated by a  
9 sudden and extraordinary increase in the level of prices in  
10 2000-2001 for power purchased in California spot electricity  
11 markets. At the time of crisis, California's utilities, such  
12 as Southern California Edison and Pacific Gas & Electric, were  
13 required to purchase their entire supply of power on the spot  
14 market.  
15 The extraordinarily high prices in the spot market,  
16 combined with the inability of investor-owned utilities to  
17 recover the difference between the price of the spot market  
18 power and the price they were entitled to recover from the rate  
19 payers, ultimately caused Southern California Edison and  
20 Pacific Gas & Electric to be unable to purchase the power they  
21 needed to keep the lights on in California.  
22 In response, the California legislature and the  
23 governor signed into law emergency legislation that authorized

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24 the Department of Water Resources to step into the breach and  
 25 purchase power, including to purchase power under long-term  
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1 power purchase agreements. Long-term contracts entered into by  
 2 the Department of Water Resources were entered into to reduce  
 3 the state's reliance on the spot market by assuring a reliable  
 4 supply of electricity for California's retail end use  
 5 customers.

6 One of the contracts that was entered into during this  
 7 time was the original version of the contract that is before  
 8 the Court in Calpine's motion to reject. That contract was  
 9 subsequently renegotiated after multiple parties in the state  
 10 of California, including the California Attorney General and  
 11 the Electricity Oversight Board, initiated actions both before  
 12 FERC and in state court seeking to recover on claims that arose  
 13 out of the energy crisis in the market manipulation that has  
 14 been so widely reported in the media.

15 Those claims included a request by the Electricity  
 16 Oversight Board and FERC to rescind the long-term contracts  
 17 entered into by the Department of Water Resources as well as  
 18 claims for refunds for excessive prices charged during that  
 19 time period by the sellers.

20 To its credit, Calpine was the first seller to step to  
 21 the table and to renegotiate its long-term contract as part of  
 22 a global settlement to settle those claims. In consideration  
 23 for the releases that it gained from the state parties, it  
 24 agreed to enter into the contract that is now before the Court  
 25 on the motion to reject by Calpine.

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1 That contract is not a plain vanilla power purchase  
 2 agreement. It has several unique features that were inserted  
 3 into the contract specifically for the purpose of addressing  
 4 the shortcomings of the California market.

5 First, and most notably, there is a special condition  
 6 called special condition 3. That condition requires Calpine to  
 7 deliver 1,000 megawatts of power into California from  
 8 generation Calpine owns outside of California in periods of  
 9 moderate to high demand. Special condition 3 requires Calpine  
 10 to deliver power to sellers not just in the market but from  
 11 Calpine's western generation assets when the supply is tight.

12 Third, when the supply is tight, as specified in the  
 13 contract, it requires Calpine to bid unutilized power from its  
 14 western generation assets into the California spot market at  
 15 just and reasonable rates. Nothing in California law would  
 16 require Calpine to meet these obligations with respect to  
 17 generation outside the California. These are strictly  
 18 contractual provisions to make sure that during tight supply  
 19 conditions Calpine would run its western generation assets and  
 20 deliver power into California rather than another western  
 21 state.

22 A second unique feature in this contract is special  
 23 condition 4. That provision addresses the lack of generation  
 24 capacity in the state of California. It commits Calpine to a  
 25 schedule to build new generation in California and gives the

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1 Department of Water Resources the ability to take over or step  
 2 into the shoes of Calpine to finish those projects if Calpine  
 3 fails to meet certain defined benchmarks that are set forth in  
 4 the contract.

5 In short, these provisions are all geared to  
 6 addressing the shortcomings of the California market during  
 7 energy crisis: Lack of capacity and the overreliance on the  
 8 spot market.

9 Now Calpine is coming before the bankruptcy court  
 10 seeking to reject this contract, and they are saying,  
 11 notwithstanding our own admission before FERC recently and the  
 12 FERC filing, that the Mobil-Sierra public interest standard of  
 13 review governs this particular contract; notwithstanding the  
 14 Federal Power Act, we can reject this contract even though  
 15 California needs the power that we are providing under this  
 16 contract.

17 It is not just the power itself, because Calpine has  
 18 said to the court that we will continue to provide that power.  
 19 It is the fact that these unique provisions commit Calpine to  
 20 providing that power into the California market from western  
 21 generation assets that are outside of California.

22 The Federal Power Act necessarily must be reviewed by  
 23 this Court to determine what standard applies to Calpine's  
 24 attempt to cease performance under the Calpine contract with  
 25 the Department of Water Resources. Congress has seen fit in

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1 the Federal Power Act to give FERC exclusive jurisdiction over  
 2 the sale of electric energy at wholesale in interstate commerce  
 3 and authority to pass upon any changes that are proposed in the  
 4 rate charged classification or services provided for in a  
 5 wholesale power purchase agreement.

6 Resolution of the issues in this case necessarily  
 7 requires substantial and material consideration of the Federal  
 8 Power Act and the many Supreme Court and other decisions  
 9 interpreting the Federal Power Act to give effect to those  
 10 provisions with respect to rates, terms, conditions, and  
 11 changes thereto. For these reasons, we believe that the  
 12 reference should be withdrawn and that these important issues  
 13 should be decided by a district court.

14 THE COURT: Thank you, sir.

15 Who is next?

16 MS. COFFINO: Diane Coffino, your Honor, on behalf of  
 17 Pacific Gas & Electric Company. I just want to hit on a couple  
 18 of points. I will try not to duplicate.

19 The first point is that this hearing is about a motion  
 20 to withdraw the reference. In deciding that, you have to  
 21 decide a couple of issues. That is, whether resolution of the  
 22 rejection motion requires substantial and material  
 23 consideration of nonbankruptcy federal law.

24 We submit that it does, because this Court, in order  
 25 to decide the rejection motion, has to determine what the

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1 intersection of the jurisdiction of the bankruptcy court under  
 2 the bankruptcy code, how that intersects with jurisdiction of  
 3 the commission under the Federal Power Act and, depending on  
 4 how that decision comes out, what the standard is to be applied

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5 to a rejection or a request to cease performance under an  
6 energy contract.

7 A lot of the debtor's arguments in the papers it filed  
8 today, this afternoon, really go to the merits. They argue  
9 that under the merits the commission has no jurisdiction. That  
10 is not what is before the Court. We have a view about that.  
11 If given the opportunity, we will present that view to you.  
12 But that is not what is before the Court today.

13 As you are aware, case decisions are driven by facts.  
14 As some of the co-movants have pointed out, the Mirant court  
15 facts were very different from the facts presented here. It is  
16 not how the debtors describe the Mirant court case in their  
17 papers. But even if Mirant were controlling here, and even the  
18 debtor's acknowledge that it is not when they attempted to  
19 disavow the Mirant case for the public interest standard, I  
20 think that the decision here would come out the same whether  
21 you applied the reasoning in NRG or under the Mirant standard.

22 Under Mirant, the Fifth Circuit made clear that the  
23 Federal Power Act does preempt a breach of contract claim when  
24 that breach of contract claim is motivated by a change in rates  
25 or a desire for a change in rates. If there is some other

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1 rationale, such as there was in Mirant where there was an  
2 oversupply and the contract wasn't needed at all at any price,  
3 that is different. But that is not what our case is.

4 The debtor's arguments on the public interest standard  
5 are equally unconvincing. They argue that the fact that Mirant  
6 held that the public interest standard shall apply and that  
7 FERC urges the same result, that a public interest standard  
8 must be considered here, does not present a conflict but in the  
9 Second Circuit it is the business judgment rule.

10 Your Honor, that begs the question. You have to  
11 answer that question. And in order to do that, you have to  
12 consider the Federal Power Act and its implications on a  
13 debtor's request to reject. That is grounds for mandatory  
14 withdrawal of the reference.

15 In the end, one thing is clear. The Mirant court and  
16 this court in the Enron case, Cal PX Enron case, said that  
17 withdrawal under these circumstances was mandated. The fact  
18 that the jurisdictional question ultimately was answered  
19 differently by the Fifth Circuit does not in any way alter the  
20 propriety of the district court's decision to pull up the case  
21 and withdraw the reference. In fact, when the Fifth Circuit  
22 remanded, it remanded to the district court.

23 In the end, your Honor, we submit that the reference  
24 should be withdrawn and we urge you to do that today, because  
25 of the pendency of the hearing tomorrow before the bankruptcy

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1 court. Thank you.

2 THE COURT: Thank you so much, ma'am.

3 MR. POWELL: Good afternoon, your Honor. Jeff Powell  
4 on behalf of the debtors. I want to start with the question  
5 your Honor asked, which is, is the reason that the debtors  
6 filed for bankruptcy due to the filing of the California  
7 parties' complaint before FERC? The answer is absolutely not.  
8 Absolutely not.

9 I think everybody agrees, your Honor, that the test

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10 here for withdrawal is whether --  
 11 THE COURT: The timing is interesting, don't you  
 12 think?  
 13 MR. POWELL: As your Honor may know, it is not part of  
 14 the record, but there was litigation in Delaware chancery court  
 15 as to ownership of certain assets of the company. It was that  
 16 litigation and the chancery court's ruling, and I think the  
 17 appellate court's ruling, that dictated this filing.  
 18 THE COURT: When did that litigation take place?  
 19 MR. POWELL: The first two weeks in December, I  
 20 believe. That is what drove this filing, your Honor, not the  
 21 fact that the California parties filed a complaint before FERC  
 22 one day before we filed for Chapter 11. A bankruptcy filing of  
 23 this size cannot be turned around and done on a dime just  
 24 because one of these parties filed before FERC the day before.  
 25 So I want to correct any misimpression there might have been  
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 1 earlier.

2 The test, I think we all agree, for mandatory  
 3 withdrawal is whether there is a material and substantial  
 4 conflict between the bankruptcy code and other, nonbankruptcy  
 5 federal laws. I would submit, with respect to both issues  
 6 raised by the movants, there is no such conflict.  
 7 With respect to the FERC jurisdiction issue, the FERC  
 8 itself made very clear yesterday that there is no conflict  
 9 between the Federal Power Act and the bankruptcy code. I  
 10 strongly disagree with the statement earlier that that order  
 11 has no significance whatsoever. That order was a statement of  
 12 the FERC's position here.  
 13 THE COURT: Have you ever seen one before?  
 14 MR. POWELL: No, sir. I am not an energy lawyer  
 15 though.  
 16 THE COURT: Neither am I.  
 17 MR. POWELL: That order was a statement of FERC's  
 18 position. It was also, your Honor, a statement of FERC's  
 19 intentions. In that order, FERC made very clear that it has no  
 20 intent to act here. It discussed the Mirant Fifth Circuit case  
 21 at length. It said that it was going to follow that authority  
 22 and said that it would not act here, that it would not supplant  
 23 the bankruptcy court's authority to authorize the rejection of  
 24 an energy contract.  
 25 THE COURT: But they offered to shape the factual  
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1 record to the court, did they not?  
 2 MR. POWELL: Yes, sir, with respect to the rejection  
 3 standard.  
 4 THE COURT: Rather than doing it themselves, but they  
 5 would shape it.  
 6 MR. POWELL: They indicated they were going to receive  
 7 submissions from interested parties and then make a submission  
 8 to the bankruptcy court as to the standard of rejection, which  
 9 I want to get to.  
 10 With respect to the jurisdictional issue itself, FERC  
 11 made very clear that it was adopting the holding in Mirant that  
 12 the Federal Power Act does not preempt section 365, and the  
 13 reason is because rejection does not impact the filed rate.  
 14 These parties may have claims for damages, but, as Mirant made



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15 very clear and as the FERC order yesterday cited, those damage  
 16 calculations will be based on the filed rate. That, your  
 17 Honor, is a statement of the FERC's position with respect to  
 18 jurisdiction. I would submit that that should be dispositive.

19 In addition, the Mirant Fifth Circuit decision should  
 20 also be dispositive.

21 THE COURT: Why should they offer to put together a  
 22 factual record for the bankruptcy court if it is a simple  
 23 bankruptcy question and does not conflict with the federal  
 24 power laws?

25 MR. POWELL: With respect to the federal rejection  
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1 standard, your Honor?

2 THE COURT: Yes. Why should they offer to do that if  
 3 this is a simple bankruptcy question?

4 MR. POWELL: I can't speak for the FERC's intentions  
 5 with respect to this order. I do think that the FERC --

6 THE COURT: If their papers come into this mix, I  
 7 think you ought to address it in any case.

8 MR. POWELL: I will, your Honor.

9 THE COURT: It seems interesting that they want to  
 10 shape your conclusion for you but they don't want to step up to  
 11 the plate and make it.

12 MR. POWELL: With respect to jurisdiction, they do not  
 13 want to step up to the plate. They do not want to supplant the  
 14 Court's authority.

15 THE COURT: They tell the Court what their authority  
 16 is, do they not?

17 MR. POWELL: What their, FERC's, authority is?

18 THE COURT: No. What the Court's authority is.

19 MR. POWELL: Yes, that is true, your Honor, they did.  
 20 They referred to the Mirant decision, and then they indicated  
 21 what they planned to do with respect to jurisdiction.

22 THE COURT: I think they go a little further than  
 23 that, sir.

24 MR. POWELL: I will say, your Honor, that when we  
 25 sought and obtained the TRO from Judge Lifland, that TRO is  
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1 still in place. There was a preliminary junction hearing  
 2 scheduled for days later, and the FERC, through the U.S.  
 3 Attorney's office, has agreed to keep that in place through  
 4 February 15th, knowing, your Honor, that the rejection hearing  
 5 was set for tomorrow.

6 I want to talk about the rejection standard, the  
 7 standard of rejection, which is the second grounds for the  
 8 movants' motions to withdraw. You are correct that the FERC  
 9 order yesterday did weigh in on that issue. Let me say a  
 10 couple of things about that.

11 First of all, the movants here, as grounds for  
 12 withdrawal, one of the reasons they would like your Honor to  
 13 withdraw the reference is they would like the Mobil-Sierra  
 14 standard to be applied to a rejection hearing. First, movants  
 15 cite not one case that has ever applied that standard to a  
 16 rejection hearing, not one case.

17 Further, in yesterday's order, FERC itself made clear  
 18 that it did not believe the Mobil-Sierra standard applied to  
 19 rejection proceedings, because there is a difference between



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20 rejection and termination, as they made clear in their order.  
 21 With respect to the Mobil-Sierra standard, FERC doesn't think  
 22 it applies, no cases have applied it, and therefore there is no  
 23 conflict between the bankruptcy code and nonbankruptcy federal  
 24 law.

25 FERC's order yesterday also discusses the rejection  
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1 standard adopted by the district court in Mirant. That  
 2 standard is currently on appeal before the Fifth Circuit. More  
 3 important, your Honor, that is not a conflict between the  
 4 bankruptcy code and other federal laws warranting withdrawal.  
 5 At most, your Honor, that is a conflict between the law of this  
 6 circuit and the law of the Fifth Circuit. That is not the kind  
 7 of conflict that satisfies Section 157(d).

8 In that respect, your Honor, that is why the FERC  
 9 statement of position with respect to the standard yesterday is  
 10 critical. No one, and movants don't cite any case to the  
 11 contrary, has argued that Mobil-Sierra applies to rejection.

12 With respect to the Mirant v. Orion issue -- by the  
 13 way, Orion was applied to energy contracts in the NRG Energy  
 14 case -- with respect to that issue, at most that is a conflict  
 15 between circuits. The fact that the movants here would like to  
 16 make new law in this circuit is not grounds for withdrawal  
 17 under 157(d). That is why, your Honor, I believe that the  
 18 FERC's action yesterday also demonstrates why withdrawal of  
 19 reference with respect to the determination of the rejection  
 20 standard also supports denial of that motion.

21 One other thing I want to address. The movants, in  
 22 their papers and in argument this afternoon, referred to the  
 23 district court's withdrawal of reference in Mirant. That is  
 24 the only case that movants have cited in which a district court  
 25 has withdrawn reference with respect to this issue. Notably,  
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1 the Fifth Circuit reversed the district court's decision and,  
 2 in reversing that decision as to jurisdiction, completely  
 3 eviscerated the basis for the district court's withdrawal of  
 4 reference to begin with.

5 Mirant made very clear, after a detailed analysis,  
 6 that there is no exemption under section 365 for energy  
 7 contracts regulated by the FERC and there was no conflict  
 8 between the bankruptcy code and the Federal Power Act, and that  
 9 the Federal Power Act does not preempt the bankruptcy court's  
 10 jurisdiction here, because rejection does not impact the filed  
 11 rate.

12 For both of those reasons, your Honor -- that there is  
 13 no conflict with respect to jurisdiction here and that there is  
 14 no conflict with respect to the standard of rejection -- we  
 15 request that your Honor deny the motions to withdraw.

16 THE COURT: Thank you, sir.

17 Does anybody need any time to reply?

18 MR. LUSKIN: Your Honor, Michael Luskin. I just  
 19 wanted to make one technical point. The Attorney General of  
 20 the State of California joins the positions made by Mr.  
 21 Cunningham on behalf of the water resources department and the  
 22 Electricity Oversight Board. We have nothing further to add to  
 23 his argument.

24 MR. SHINDERMAN: Your Honor, Mark Shinderman of Munger  
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25 Tolles & Olson again. Your Honor, if I may be afforded three  
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1 minutes to respond to the points raised by Calpine?

2 THE COURT: If you stick to that.

3 MR. SHINDERMAN: Thank you, your Honor. There are  
4 seven specific points which I wish to handle. The first is  
5 that resolution of the rejection motion requires in the first  
6 instance a determination of what court and what standard should  
7 be applied. To answer those two questions, this Court must  
8 necessarily consider both the Federal Power Act and the  
9 bankruptcy code. So just to answer the predicate question  
10 requires the consideration of bankruptcy law and federal  
11 nonbankruptcy law such that withdrawal of the reference is  
12 mandatory under 28 U.S.C. 157(d).

13 Second, the debtor would ignore the public interest in  
14 this case, but the debtor hasn't told you what was implied in  
15 the papers, which is that if the debtor is free to reject these  
16 contracts and then sell the same power into the marketplace it  
17 is already selling to the same parties in the marketplace,  
18 ultimately the consumers, the public interest, will have to pay  
19 more money. That is why the commission said the public  
20 interest is relevant.

21 The third point I would like to make is the reason for  
22 debtor's filing. As your Honor stated, the time of the filing  
23 was curious. Your Honor, according to information that is  
24 publicly available, this company, the debtor, Calpine, had  
25 until January 22nd to pay back the money. So we think, as I

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1 stated before, that certainly the presence of the California  
2 application to the commission certainly influenced the timing  
3 of the bankruptcy petition. And I would note that on the first  
4 day of the bankruptcy case, the debtor, on an ex parte basis,  
5 obtained a temporary restraining order against the commission  
6 from proceeding.

7 The fourth issue touched upon by the debtor is what  
8 significance should be afforded the guidance. On the one hand,  
9 the debtor says the guidance is very important because in the  
10 guidance the commission is abdicating -- I shouldn't say  
11 abdicating -- is willing to let the bankruptcy court proceed to  
12 a decision. But at the same time, the debtor turns around and  
13 says, but the conditions under which the commission wants to do  
14 that, to provide an opportunity for the public to be heard and  
15 for the commission to weigh in on that public interest, the  
16 debtor rejects.

17 On the one hand, the debtor would have adopted the  
18 guidance as being informative and influential because it  
19 informs deference to the bankruptcy court. On the other hand,  
20 the predicate to the deference, that the commission be allowed  
21 an opportunity to protect the public interest consistent with  
22 the Federal Power Act, should be ignored.

23 Your Honor, as we point out in the guidance, Mirant is  
24 not the standard adopted by any court in this circuit. The  
25 commission starts with the proposition that it is bound and

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1 therefore should follow Mirant. Second, Mirant also stands for  
 2 the proposition that if what the debtor is trying to do is  
 3 abrogate its contract so it can charge a higher rate, as is the  
 4 case here, then the commission's jurisdiction is exclusive.  
 5 The Fifth Circuit opinion contains the concession of Mirant  
 6 that if it was just about abrogating rates so it could charge a  
 7 different price or pay a different price, then the commission's  
 8 jurisdiction would be absolute.

9 The debtor also established a fifth point, that there  
 10 is no authority for the proposition that the Mobil-Sierra  
 11 standard should be applied to rejection of an executory  
 12 contract. The answer to that is very simple. When that issue  
 13 was brought before this Court previously, this Court said, we  
 14 have to defer to the absolute jurisdiction of the commission.

15 So you won't see any opinions that say the  
 16 Mobil-Sierra standard should be applied to a bankruptcy court's  
 17 decision to reject an executory contract for the purchase of  
 18 power, because in any situation that that would have arisen,  
 19 reference was withdrawn and/or the court paid deference to the  
 20 exclusive jurisdiction of the commission.

21 Two more points. Curiously, absent from the debtor's  
 22 position is any adoption of the standard or the interest that  
 23 the commission believes it is bound to protect under its  
 24 jurisdiction.

25 Finally, I would note one issue that this Court would  
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1 have to consider as a predicate to moving forward is whether or  
 2 not the commission has the power to relinquish the jurisdiction  
 3 which this Court and others and the commission in prior cases  
 4 has said is absolute. It is an issue that requires resolution.

5 Finally, the your Honor, the debtor ended its  
 6 presentation by stating that there was only one authority for  
 7 the proposition that in considering motions to reject purchase  
 8 power contracts, a reference must be withdrawn. That is the  
 9 Mirant case. Conversely, the debtor doesn't point to any case  
 10 where a motion to withdraw the reference was denied.

11 Furthermore, the only reason one could characterize  
 12 the Fifth Circuit as eviscerating standards for withdrawal of  
 13 the reference in the future is because the Fifth Circuit has  
 14 set forth the standard that should guide all future courts  
 15 within the Fifth Circuit in the rejection decision, a  
 16 modification of what would otherwise be applied by the debtor  
 17 in the bankruptcy court in this case.

18 So, your Honor, wrapping this all up and bringing it  
 19 back to the beginning, the predicate to the rejection motion is  
 20 what forum and what standard gets applied. To resolve those  
 21 two questions, a court must necessarily consider the interplay  
 22 between the bankruptcy code and the Federal Power Act such that  
 23 withdrawal of the reference is mandatory.

24 MR. POWELL: Your Honor, Jeff Powell for the debtors.  
 25 May I be heard?

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1 THE COURT: Briefly.

2 MR. POWELL: Briefly, yes, sir. Three quick points.

3 The grounds for the movants' withdrawal motion is that  
 4 there is a conflict. The FERC spoke yesterday and made it  
 5 clear that they do not have jurisdiction to get involved in the

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6 rejection issue and that there is no conflict. The FERC has  
 7 spoken here and indicated its intentions: Namely, it does not  
 8 intend to act. That should resolve the jurisdiction argument,  
 9 the claimed conflict, raised by these parties. That is point  
 10 one.

11 Point two is the FERC did not abdicate its  
 12 jurisdiction, your Honor, not even close to it. The FERC said  
 13 it did not have jurisdiction. It did not abdicate something  
 14 that it made clear it does not have.

15 Third, several of the attorneys here have talked about  
 16 supply considerations and perhaps rate considerations.

17 THE COURT: Does the Court have the power to tell the  
 18 FERC what their jurisdiction is, as opposed to FERC attempting  
 19 to tell the Court what their jurisdiction is?

20 MR. POWELL: I'm sorry. Could you repeat that?

21 THE COURT: Does the Court have the power to tell the  
 22 FERC what their jurisdiction is, as opposed to the FERC  
 23 attempting, as they did in their letter, to tell the Court what  
 24 their jurisdiction is?

25 MR. POWELL: I don't believe that the Court, or the  
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1 movants by a withdrawal motion, have the power to force the  
 2 FERC to get involved in this decision.

3 THE COURT: That wasn't the question.

4 MR. POWELL: I must have misunderstood your question,  
 5 your Honor.

6 THE COURT: Does the Court have the power to tell the  
 7 FERC what their jurisdiction is?

8 MR. POWELL: No, sir.

9 THE COURT: Who does?

10 MR. POWELL: Who does? I believe the FERC does and  
 11 the --

12 THE COURT: FERC decides their own jurisdiction?

13 MR. POWELL: And of course the courts of appeals, your  
 14 Honor, under the regulatory framework.

15 The third point is that these claims of concern about  
 16 supply and rate considerations, your Honor, were made in the  
 17 complaint to the FERC. The FERC was aware of those concerns  
 18 before it issued its order yesterday. More important, and  
 19 last, those concerns have nothing to do with the issue before  
 20 your Honor, which is Section 157 withdrawal. If movants wish  
 21 to make those arguments, they can make those arguments where  
 22 they should make them, which is before the bankruptcy court,  
 23 your Honor.

24 Thank you.

25 THE COURT: What time is the hearing tomorrow morning  
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1 before the bankruptcy court? Is it morning? What time  
 2 tomorrow?

3 MR. POWELL: Yes, sir. 10 a.m.

4 THE COURT: We will take a brief recess. Then I will  
 5 inform you whether I will decide the motion right now or I will  
 6 issue an opinion by tomorrow morning in time for your hearing  
 7 before the bankruptcy court. If you will indulge us for a few  
 8 minutes, I will come back and tell you when it will issue.

9 (Recess)

10 THE COURT: Counsel, I have considered your oral

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11 arguments carefully. The Court has reviewed your papers. We  
12 are prepared to give you a decision now.

13 The issues involved in this case are complex and  
14 involve the delicate separation of powers in the United States.  
15 Resolution of the underlying rejection motion requires  
16 substantial and material consideration of the interaction of  
17 federal law and bankruptcy law that require significant  
18 interpretation, including but not limited to what forum has the  
19 authority to reject FERC-related wholesale energy contracts and  
20 whether the business judgment or public interest standard  
21 should apply. As such, the Court must withdraw the reference  
22 to the bankruptcy court pursuant to 28 U.S.C. Section 157.

23 The Court finds that neither the Fifth Circuit  
24 decision in *Mirant* nor the FERC's order providing interim  
25 guidance resolves the issue. The former perhaps clarifies the

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1 law in the Fifth Circuit, while the latter has no power to  
2 dictate the jurisdiction of or standards to be applied in the  
3 district court. This is so notwithstanding the fact that the  
4 FERC order seeks to enlarge this Court's jurisdiction or that  
5 its recommendation as to the application of the public interest  
6 standard may be wise.

7 The separation of powers dictates this Court's  
8 decision, and inasmuch, the motion to withdraw the reference as  
9 to the motion of the debtors for entry of an order authorizing  
10 debtors to reject the energy contracts is granted.

11 Counsel, I believe that concludes our business at  
12 hand. There may be subsequent applications or conferences.  
13 After deliberations amongst yourselves, you may consult with my  
14 deputy clerk. Thank you. Good evening. Have a safe trip  
15 home. The court will stand in recess.

(Adjourned)

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